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No. 88-412

In The
Supreme Court Of The United States

OCTOBER TERM, 1988

MARTIN W. HOFFMAN, TRUSTEE
Petitioner

v.

CONNECTICUT DEPARTMENT OF INCOME MAINTENANCE, ET AL.
Respondents

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

JOINT APPENDIX

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PETITION FOR CERTIORARI FILED SEPTEMBER 7, 1988
CERTIORARI GRANTED JANUARY 9, 1989

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DATE	PROCEEDINGS
1-03-84	Complaint filed by Trustee.
2-03-84	Defendant's Memorandum in Support of Motion to Dismiss.
2-03-84	Defendant's Motion to Dismiss.
3-07-84	Plaintiff's Memorandum in Support of the Motion in Opposition to Defendant's Motion to Dismiss.
3-07-84	Motion in Opposition to Defendants' Motion to Dismiss.
4-25-84	Memorandum & Order *Denying* Defendant's Motion to Dismiss: Attys. Martin Hoffman, Kenneth Graham & Arnold Menchel (State of Ct.), Stanley Peck (State of Ct).
5-16-84	Order Granting Motion for Stay of Memorandum & Order dated 4/25/84 CC: Attys. Martin Hoffman, Stanley Peck, Ken Graham & Arnold Menchel, per
5-25-84	Notice of Appeal by St. of Ct., Dept. of Income Maintenance, Dept. of Health Services, Def. on Denial of Motion to Dismiss.
6-05-84	Copy of Record on Appeal received from Bankruptcy Office. Appeal is on Denial of Motion to dismiss. Notice mailed to counsel.
6-20-84	Brief of the Appellants filed.
7-10-84	Brief of the Appellee M. Hoffman filed.

7-27-84 Reply Brief of Appellants filed.

6-18-85 Certification Order Pursuant to 28 U.S.C. Sec. 2403(b) Atty. General to report re: intervention on or by 7-19-85 Dorsey, J. — cc mld (LW).

9-20-85 Motion for Intervention of the United States with attached Brief in support fld (LW).

9-27-85 Intervening Brief of the United States fld (LW).

10-18-85 END on dckt #16 "GRANTED", Dorsey, J. — cc mld (CB).

5-11-87 Memorandum of Decision (The ruling of Bankruptcy Court is reversed and appellants' Mot. to Dismiss is GRANTED.) Dorsey, J. — cc mld (LW) M. 5/12/87.

5-12-87 Judgment fld and entered deft. Rowe, C. — cc mld (LW) M/5/15/87.

6-04-87 Notice of Appeal from final judgment. Fee paid. Civil Management Plan and Forms C & D handed to appellant's counsel. Certified copy of notice and docket sheet mld to USCA; copies to counsel (CB).

6-08-87 Copy of district court docket entries and notice of appeal on behalf of the appellant Martin W. Hoffman, Trustee, filed.

10-09-87 Appellant Martin Hoffman, Trustee — brief filed (W/pfs).

10-09-87 Appellant Martin Hoffman, Trustee — appendix filed (w/pfs).

11-09-87 Appellee Connecticut Dept. of Income Maintenance filed briefs w/pfs.

11-13-87 Intervenor-Appellee USA — brief filed (w/pfs) (OK per MJ).

11-20-87 Order granted Appellee Connecticut Dept. of Income Maintenance motion for to filed supplemental appendix filed (EBG).

11-23-87 Appellant Martin W. Hoffman, Trustee reply brief filed w/pfs.

1-27-88 Case heard before Oakes, Newman, Miner, C.JJ.

6-15-88 Judgment Affirmed by published signed opinion per Judge Miner (& in 87-5023) Judgment Filed.

Chapter 7 Proceeding No. 2-82-00508
Adversary Proceeding No. 2-84-0007

UNITED STATES BANKRUPTCY COURT
DISTRICT OF CONNECTICUT

WILLINGTON CONVALESCENT HOME, INC.
Debtor

MARTIN W. HOFFMAN, TRUSTEE
Plaintiff

v.

STATE OF CONNECTICUT,
DEPARTMENT OF INCOME MAINTENANCE
DEPARTMENT OF HEALTH SERVICES,
Defendants

COMPLAINT

(dated December 30, 1983)

---

1. Willington Convalescent Home, Inc. filed a Chapter 11 Proceeding on June 2, 1982. Said matter was converted to a Chapter 7 Proceeding on July 27, 1983, and Martin W. Hoffman, Esq., was appointed as Trustee of said estate on that date.

2. This adversary proceeding is brought pursuant to Rule 701 of the Rules of Bankruptcy Procedure to recover a money judgment against the Defendants for services sold and delivered on account. Jurisdiction is conferred on this Court by 28 U.S.C. Section 1471.

3. The Defendant, Department of Health Services, has an address of 110 Bartholomew Avenue, Hartford, Connecticut 06115.

4. The Defendant, Department of Health Services, has an address of 79 Elm Street, Hartford, Connecticut.

5. Prior to the commencement of this action, the Debtor performed services on account to the Defendants in the amount of $64,010.24.

6. Said amount has been due and owing to the Debtor for more than ninety (90) days.

7. Notwithstanding demand, the Defendants have failed to pay the amount due on said account.

WHEREFORE, Plaintiff prays that this Court:

1. Enter a judgment of money damages against the Defendants for the amount due on said account, together with interest thereon.

2. Grant the Debtor such other and further relief as the Court may deem just and proper, including costs of this action.

Dated at Hartford, Connecticut, this 30th day of December, 1983.

PLAINTIFF:
Martin W. Hoffman, Trustee

By /s/ Martin W. Hoffman

Martin W. Hoffman
Attorney for the Trustee
410 Asylum Street
Hartford, CT 06103

UNITED STATES BANKRUPTCY COURT
DISTRICT OF CONNECTICUT

(Caption omitted in printing)

MOTION TO DISMISS

(February 3, 1984)

Pursuant to the Federal Rules of Civil Procedure, Rule 12(b) (1) and (6) and Bankr. Rule 7012, 11 U.S.C.A. (effective August 1, 1983), the defendants respectfully move the Court to dismiss the above-entitled Adversary Proceeding due to a lack of jurisdiction over the subject matter and failure to state a claim upon which relief can be granted for the following reasons:

1. The sole business relationship between the debtor and the defendant state agencies was the debtor's former status as a "nursing home" provider participant in the Connecticut Medicaid Program until March of 1983 (See attached Affidavit in Support of Motion to Dismiss).

2. As a nursing home provider participant in the Connecticut Medicaid Program, the debtor submitted annual reports for cost years ending September thirtieth of each year which constituted the basis for computation of annual per diem Medicaid rates to commence July first of the following year. While the Department of Income Maintenance took the word of debtor as to the representations made in said annual reports, said resulting Medicaid rates were subject to subsequent field audit and retroactive rate recomputation if unallowable costs were discovered. See Regulations of Connecticut State Agencies § 17-311-50 *et seq.* ("Medicaid Cost Related Reimbursement System") and the attached Affidavit in Support of Motion to Dismiss).

3. A field audit report dated December 3, 1980 determined that debtor had included unallowable costs in its annual

reports and had therefore received Medicaid overpayments. The Department of Income Maintenance issued two (2) Medicaid rate decisions for different rate years implementing the recommended retroactive revised Medicaid rate recomputations which resulted in both prepetition and postpetition recoupment from monthly Medicaid payment checks to debtor in partial satisfaction of debtor's indebtedness to the State for most Medicaid overpayments. Said recoupment ceased when the debtor ceased operations in early 1983 (See attached Affidavit).

4. The provider agreements between the debtor and the Department of Income Maintenance were in the nature of an executory contract which gave the Medicaid Program the right to recoup past Medicaid overpayments from the debtor's monthly Medicaid checks because a debtor may not accept an executory contract's benefits while evading its burdens. The trustee's complaint is therefore barred.

5. The Eleventh Amendment to the Constitution of the United States operates as a bar to the trustee's complaint because the entirety of said complaint seeks retroactive pecuniary relief from a federal court against a state government where the state has not waived its Eleventh Amendment immunity.

6. The Sovereign Immunity enjoyed by the State of Connecticut operates as a bar to the trustee's complaint as the defendant state agencies have filed no claim against debtor's estate, no objection to discharge, no request for affirmative relief from the Bankruptcy Court and are not the plaintiffs in any other forum pursuing a claim against debtor's estate.

7. With respect to aforesaid second Medicaid rate decision, concerning which debtor made a timely administrative Medicaid rate hearing request but then requested that said hearing be postponed indefinitely, the debtor's failure to exhaust its available administrative remedy operates as a bar to the trustee's complaint. In the alternative, the doctrine of

primary jurisdiction operates as a bar to the trustee's complaint.

8. With respect to the aforesaid first Medicaid rate decision concerning which the debtor failed to make a timely administrative Medicaid rate hearing request, said decision is final and correct as a matter of law and entitled to res judicata effect and statutory full faith and credit as per 28 U.S.C. § 1738, thereby operating as a bar to the trustee's complaint.

WHEREFORE, THE DEFENDANTS PRAY DISMISSAL OF THE TRUSTEE'S COMPLAINT.

DEFENDANT, CONNECTICUT DEPARTMENT OF INCOME MAINTENANCE,

BY ITS ATTORNEY
JOSEPH I. LIEBERMAN
ATTORNEY GENERAL

By: /s/ Kenneth A. Graham

Kenneth A. Graham
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Hartford, CT 06114
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By: /s/ Arnold I. Menchel

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Assistant Attorney General
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DEFENDANT, CONNECTICUT DEPARTMENT OF HEALTH SERVICES

BY ITS ATORNEY
JOSEPH I. LIEBERMAN
ATTORNEY GENERAL

By: /s/ Stanley K. Peck

Stanley K. Peck
Assistant Attorney General
30 Trinity Street
Hartford, CT 06106
Telephone: 566-4990

ORDER

The foregoing Motion to Dismiss, having been duly heard by the Court, it is hereby GRANTED/DENIED

U.S. Bankruptcy Judge

(Certificate of Service omitted in printing)

UNITED STATES BANKRUPTCY COURT
DISTRICT OF CONNECTICUT

(Caption omitted in printing)

MOTION IN OPPOSITION TO DEFENDANTS' MOTION TO DISMISS

(March 6, 1984)

The Plaintiff, Martin W. Hoffman, Trustee, respectfully requests that the Defendants' Motion to Dismiss be denied as this Court has jurisdiction over the subject matter. Additionally, Defendants' Motion to Dismiss should be denied as the Plaintiff has stated a claim upon which relief can be granted.

PLAINTIFF:
Martin W. Hoffman, Trustee

By /s/ Martin W. Hoffman

Martin W. Hoffman
Attorney for the Trustee
410 Asylum Street
Hartford, CT 06103
Tel. (203) 525-4287

(Certificate of Service omitted in printing)

ORDER

DATED AT HARTFORD, CONNECTICUT, THIS _____ DAY OF _____, 1984.

Upon the foregoing Motion in Opposition to Defendants' Motion to Dismiss, having been duly heard by the Court, it is hereby

ORDERED: Granted/denied.

_____
ROBERT L. KRECHEVSKY
UNITED STATES BANKRUPTCY JUDGE

UNITED STATES BANKRUPTCY COURT
DISTRICT OF CONNECTICUT

In The Matter Of:	Case No. 2-83-00508
WILLINGTON CONVALESCENT HOME, INC. Debtor	)
MARTIN W. HOFFMAN, TRUSTEE Plaintiff	)
V.	) Adversary Proceeding
STATE OF CONNECTICUT, DEPARTMENT OF INCOME MAINTENANCE, DEPT. OF HEALTH SERVICES, Defendant	) No. 2-84-0007

CONSENT TO ENTRY OF JUDGMENT OR DISPOSITIVE ORDER BY A UNITED STATES BANKRUPTCY JUDGE

In accordance with the provisions of the Emergency Resolution for Administration of Bankruptcy System adopted by the United States District Judges for the District of Connecticut on December 22, 1982, the parties to the above-captioned related proceeding hereby waive their right to have the Bankruptcy Judge submit findings, conclusions, and a proposed judgment or order to a District Judge and consent to have a Bankruptcy Judge hear the proceeding and enter a final judgment or dispositive order. The parties expressly reserve all rights to appeal the merits of such final judgment or dispositive order.

/s/ Martin W. Hoffman	April 5, 1984
Martin W. Hoffman, Attorney for the Trustee	DATE
/s/ Kenneth A. Graham	April 10, 1984
Kenneth A. Graham, Assistant Attorney General	DATE
/s/ Arnold I. Menchel	April 10, 1984
Arnold I. Menchel, Assistant Attorney General	DATE
/s/ Stanley K. Peck	April 10, 1984
Stanley K. Peck, Assistant Attorney General	DATE

UNITED STATES DISTRICT COURT
DISTRICT OF CONNECTICUT

EMERGENCY RESOLUTION FOR ADMINISTRATION OF BANKRUPTCY SYSTEM

We, the United States District Judges for the District of Connecticut, hereby unanimously adopt the following Emergency Resolution for the Administration of the Bankruptcy System in the District of Connecticut, acting pursuant to an Order of the Judicial Council of the Second Circuit:

"BE IT ENACTED:

(a) Emergency Resolution

The purpose of this rule is to supplement existing law and rules in respect to the authority of the Bankruptcy Judges of this District to act in bankruptcy cases and proceedings until Congress enacts appropriate remedial legislation in response to the Supreme Court's decision in *Northern Pipeline Construction Co. v. Marathon Pipe Line Co.*, ____ U.S. ____, 102 S.Ct. 2858 (1982), or until March 31, 1984, whichever first occurs.

The Judges of the District Court find that exceptional circumstances exist. These circumstances include: . . . (1) the unanticipated unconstitutionality of the grant of power to Bankruptcy Judges in § 241(a) of Public Law 95-598; (2) the clear intent of Congress to refer bankruptcy matters to Bankruptcy Judges; (3) the specialized expertise necessary to the determination of bankruptcy matters; and (4) the administrative difficulty of the District Courts' assuming the existing bankruptcy caseload on short notice.

Therefore, the orderly conduct of the business of the Court requires this referral of bankruptcy cases to the Bankruptcy Judges.

(b) Filing of Bankruptcy Papers

The Bankruptcy Court constituted by § 404 of Public Law 95-598 shall continue to be known as the United States Bankruptcy Court of this District. The Clerk of the Bankruptcy Court is hereby designated to maintain all files in bankruptcy cases and adversary proceedings. All papers in cases or proceedings arising under or related to Title 11 shall be filed with the Clerk of the Bankruptcy Court regardless of whether the case or proceeding is before a Bankruptcy Judge or a Judge of the District Court, except that a judgment by the District Judge shall be filed in accordance with Rule 921 of the Bankruptcy Rules.

(c) Reference to Bankruptcy Judges

(1) All cases under Title 11 and all civil proceedings arising under Title 11 or arising in or related to cases under Title 11 are referred to the Bankruptcy Judges of this District.

(2) The reference to a Bankruptcy Judge may be withdrawn by the District Court at any time on its own motion or on timely motion by a party. A motion for withdrawal of reference shall not stay any bankruptcy matter pending before a Bankruptcy Judge unless a specific stay is issued by the District Court. If a reference is withdrawn, the District Court may retain the entire matter, may refer part of the matter back to the Bankruptcy Judge, or may refer the entire matter back to the Bankruptcy Judge with instructions specifying the powers and functions that the Bankruptcy Judge may exercise. Any matter in which the reference is withdrawn shall be reassigned to a District Judge in accordance with the Court's usual system for assigning civil cases.

(3) Referred cases and proceedings may be transferred in whole or in part between Bankruptcy Judges within the District without approval of a District Judge.

(d) Powers of Bankruptcy Judges

(1) The Bankruptcy Judges may perform in referred bankruptcy cases and proceedings all acts and duties necessary for

the handling of those cases and proceedings except that the Bankruptcy Judges may not conduct:

(A) a proceeding to enjoin a court;

(B) a proceeding to punish a criminal contempt —

(i) not committed in the Bankruptcy Judge's actual presence; or

(ii) warranting a punishment of imprisonment;

(C) an appeal from a judgment, order, decree, or decision of a United States Bankruptcy Judge; or

(D) jury trials.

Those matters which may not be performed by a Bankruptcy Judge shall be transferred to a District Judge.

(2) Except as provided in (d)(3), orders and judgments of Bankruptcy Judges shall be effective upon entry by the Clerk of the Bankruptcy Court, unless stayed by the Bankruptcy Judge or a District Judge.

(3) (A) Related proceedings are those civil proceedings that, in the absence of a petition in bankruptcy, could have been brought in a District court or a State Court. Related proceedings include, but are not limited to, claims brought by the estate against parties who have not filed claims against the estate. Related proceedings do not include: contested and uncontested matters concerning the administration of the estate; allowance of and objection to claims against the estate; counterclaims by the estate in whatever amount against persons filing claims against the estate; orders in respect to obtaining credit; orders to turn over property of the estate; proceedings to set aside preferences and fraudulent conveyances; proceedings in respect to lifting of the automatic stay; proceedings to determine dischargeability of particular debts;

proceedings to object to the discharge; proceedings in respect to the confirmation of plans; orders approving the sale of property where not arising from proceedings resulting from claims brought by the estate against parties who have not filed claims against the estate; and similar matters. A proceeding is not a related proceeding merely because the outcome will be affected by state law.

(B) In related proceedings the Bankruptcy Judge may not enter a judgment or dispositive order, but shall submit findings, conclusions, and a proposed judgment or order to the District Judge, unless the parties to the proceeding consent to entry of the judgment or order by the Bankruptcy Judge.

(e) District Court Review

(1) A notice of appeal from a final order or judgment or proposed order or judgment of a Bankruptcy Judge or an application for leave to appeal an interlocutory order of a Bankruptcy Judge, shall be filed within ten (10) days of the date of entry of the judgment or order or of the lodgment of the proposed judgment or order. As modified by §§ (e) 2A and B of this rule, the procedures set forth in Part VIII of the Bankruptcy Rules apply to appeals of Bankruptcy Judges' judgments and orders and the procedures set forth in Bankruptcy Interim Rule 8004 apply to applications for leave to appeal interlocutory orders of Bankruptcy Judges. Modification by the District Judge or the Bankruptcy Judge of time for appeal is governed by Rule 802 of the Bankruptcy Rules.

(2) (A) A District Judge shall review:

(i) an order or judgment entered under paragraph (d)(2) if a timely notice of appeal has been filed or if a timely application for leave to appeal has been granted;

(ii) an order or judgment entered under paragraph (d)(2) if the Bankruptcy Judge certifies that circumstances require that the order

or judgment be approved by a District Judge, whether or not the matter was controverted before the Bankruptcy Judge or any notice of appeal or application for leave to appeal was filed; and

(iii) a proposed order or judgment lodged under paragraph (d)(3), whether or not any notice of appeal or application for leave to appeal has been filed.

(B) In conducting review, the District Judge may hold a hearing and may receive such evidence as appropriate and may accept, reject, or modify, in whole or in part, the order or judgment of the Bankruptcy Judge, and need give no deference to the findings of the Bankruptcy Judge. At the conclusion of the review, the District Judge shall enter an appropriate order or judgment.

(3) When the Bankruptcy Judge certifies that circumstances require immediate review by a District Judge of any matter subject to review under paragraph (d)(2), the District Judge shall review the matter and enter an order or judgment as soon as possible.

(4) It shall be the burden of the parties to raise the issue of whether any proceeding is a related proceeding prior to the time of the entry of the order of judgment of the District Judge after review.

(f) Local Rules

In proceedings before a Bankruptcy Judge, the local rules of the Bankruptcy Court shall apply. In proceedings before a Judge of the District Court, the local rules of the District Court shall apply.

(g) Bankruptcy Rules and Title IV of Public Law 95-598

Courts of bankruptcy and procedure in bankruptcy shall continue to be governed by Title IV of Public Law 95-598 as amended and by the bankruptcy rules prescribed by the Supreme Court of the United States pursuant to 28 U.S.C. § 2075 and limited by § 405(d) of the Act, to the extent that

such Title and Rules are not inconsistent with the holding of *Northern Pipeline Construction Co. v. Marathon Pipe Line Co.*, ____ U.S. ____, 102 S.Ct. 2858 (1982).

(h) Effective Date and Pending Cases

This rule shall become effective December 25, 1982, and shall apply to all bankruptcy cases and proceedings not governed by the Bankruptcy Act of 1898 as amended, and filed on or after October 1, 1979. Any bankruptcy matters pending before a Bankruptcy Judge on December 25, 1982 shall be deemed referred to that Judge."

Dated at Bridgeport, Connecticut, this 22nd day of December, 1982.

/s/ T. Emmet Clarie

T. Emmet Clarie
Chief United States District Judge

/s/ T.F. Gilroy Daly

T.F. Gilroy Daly
United States District Judge

/s/ Ellen B. Burns

Ellen Bree Burns
United States District Judge

/s/ Warren W. Eginton

Warren W. Eginton
United States District Judge

/s/ José A. Cabranes

José A. Cabranes
United States District Judge

Civil H 84-636 PCD

UNITED STATES DISTRICT COURT
DISTRICT OF CONNECTICUT

WILLINGTON CONVALESCENT HOME, INC.

STATE OF CONNECTICUT,
DEPARTMENT OF INCOME MAINTENANCE
DEPARTMENT OF HEALTH SERVICES,

v.

MARTIN W. HOFFMAN, TRUSTEE

JUDGMENT

This action having come on for consideration of the appellant State of Connecticut's motion to appeal decision of bankruptcy court before the Honorable Peter C. Dorsey, United States District Judge, and

The Court having considered the full record of the case including applicable principles of law, and the Court having filed its Memorandum of Decision, reversing the decision of the bankruptcy and granting the motion to dismiss,

It is accordingly ORDERED, ADJUDGED and DECREED that judgment be and is hereby entered.

Dated at Hartford, Connecticut, this 12th day of May 1987.

KEVIN F. ROWE, Clerk

By /s/ Dennis P. Iavarone

Dennis P. Iavarone
Deputy-in-Charge

(Pages 47-57 of Connecticut's Brief dated June 20, 1984)

ARGUMENT III

THE STATE MEDICAID AGENCY'S RIGHT TO RECOUP PAST MEDICAID OVERPAYMENTS FROM THE MONTHLY MEDICAID PAYMENT CHECKS SENT TO A NURSING HOME DEBTOR

A. FACTUAL INTRODUCTION

From the perspective of Appellant Connecticut Department of Income Maintenance, Judge Krechevsky's decision on this issue constitutes the greatest fiscal threat to the fiscal integrity of the Connecticut Medicaid Program of the five (5) separate and distinct grounds of the denied Motion to Dismiss.*

As described in the Statement of the Case, *supra*, the State takes the word of the nursing home as to the costs claimed in the facility's unaudited annual cost report and computes the facility's annual Medicaid rate in reliance. Of course, pursuant to the provider agreement between the State Medicaid agency and the nursing home in the Medicaid Program, *subsequent* field audits occur generally on a biennial basis and if unallowable costs are discovered, the Medicaid rates are recomputed and recoupment of the past Medicaid overpayments occurs from the monthly Medicaid payment checks sent by the State to the nursing home.

Obviously, the consideration of the contract for the nursing home are the Medicaid rates which determine the amount paid to the facility.

Equally obviously, the consideration for the State Medicaid agency is that Medicaid tax dollars paid to a nursing home are in fact spent on the care of Title XIX Medicaid

* The budget of the Connecticut Department of Income Maintenance is approximately 25% of the entire annual State budget, and the nursing home Medicaid payments constitute the largest single component of said agency budget.

patients and not illegally diverted elsewhere. Therefore, the subsequent field audit/rate recomputation/recoupment part of the provider agreement is the heart of the State's consideration, i.e., the essence of the contract.

As will soon be demonstrated, until Judge Krechevsky's decision five (5) of the six (6) bankruptcy cases on this point came down in favor of the right of the Medicare/Medicaid government agency to recoup such past overpayments from current payment checks to nursing homes even after they filed in bankruptcy on the theory that a nursing home could not accept the benefits of its executory contract (continued participation in Medicare/Medicaid and continued payment checks from the government) while evading the burdens of the same contract (field auditing and recoupment of past overpayments).

So long as this line of bankruptcy case law remains the law, a deterrent exists against nursing home owners filling their annual cost reports with false claims and pocketing illegal Medicaid overpayments for a few years until the field auditors catch them, *to wit*, they know that whether or not they file in bankruptcy, the past overpayments will be recouped.

Judge Krechevsky totally misunderstood the Appellants' argument to be that any monies the Trustee recovers post petition would go into the pockets of the nursing home owner. Of course not. But that was not the State's argument. Rather, the above described deterrent discourages prepetition filing of false or questionable cost claims and prepetition personal pocketing of overpayments by the average nursing home owner who realizes that filing in Chapter 11 will not prevent the requisite recoupment. (Again, see the Statement of the Case as to why nursing homes already have an incentive to file in bankruptcy even without elimination of said deterrent.)

B. THE PROVIDER AGREEMENTS BETWEEN THE DEBTOR AND THE DEPARTMENT OF INCOME MAINTENANCE CONSTITUTED AN EXECUTORY CONTRACT WHICH GAVE THE STATE MEDICAID AGENCY THE RIGHT TO RECOUP PAST MEDICAID OVERPAYMENTS FROM THE DEBTOR NURSING HOME'S MONTHLY MEDICAID CHECKS BECAUSE A DEBTOR MAY NOT ACCEPT AN EXECUTORY CONTRACT'S BENEFITS WHILE EVADING ITS BURDENS.

The landmark bankruptcy case on this issue is *In Re Monsour Medical Center*, 8 B.R. 606 (Bankr. W.D. Penn. 1981), aff'd. 11 B.R. 1014 (W.D. Penn. 1981).

The *Monsour* bankruptcy court held that three (3) different annual provider agreements between Medicare and the provider *constituted one (1) executory contract* (8 B.R. at 613), and that on the date the debtor filed in bankruptcy, the government continued to have the contractual right to make rate adjustments to minimize overpayment with the debtor having the ongoing contractual right to invoke the contract's dispute procedures (8 B.R. at 614) as if bankruptcy had not intervened (8 B.R. at 615).

On appeal, the *Monsour* district court rejected the facility's argument that its different one year provider agreements constituted separate and distinct contracts as opposed to one executory contract (11 B.R. at 1017) and then found that rate adjustments by the government were part of the executory contract and "do not violate the provisions of the Bankruptcy Code staying collection of antecedent debts." 11 B.R. at 1018.

In the bankruptcy case *In Re Berger*, 16 B.R. 236 (Bankr. S.D. Fla. 1981), a Medicare provider moved for a contempt citation against the government for recouping past Medicare overpayments from Medicare payments made to the debtor *after* filing in bankruptcy. The *Berger* bankruptcy court held: "I agree with the [*Monsour*] District Court's conclusion that

the adjustments of current payments in accordance with . . . the contractual agreement . . . do not violate the provisions of § 362." 16 B.R. at 237.

In *In Re Yonkers Hamilton Sanitarium, Inc.*, 22 B.R. 427 (Bankr. S.D.N.Y. 1982), the bankruptcy trustee for a Medicare provider argued that *Monsour* and *Berger* were incorrectly decided as viewing the relationship between the parties as if no bankruptcy had been filed, and in the alternative, the recoupment could not be affected because the provider agreement had neither been assumed nor rejected. 22 B.R. at 434.

Bankruptcy Judge Schwartzberg rejected the trustee's arguments holding:

> "It does not follow, however, that if neither party to an executory contract . . . takes any action with respect to assumption or rejection, the contract has no significance. *As long as the debtor continues to receive benefits under such contract it must also bear the burdens or obligations imposed under the contract.* [citation omitted] The *Monsour* and *Berger* cases are consistent with this principle *and were not incorrectly decided*, as the trustee's counsel contends." 22 B.R. at 435 (emphasis added)

The one and only case adverse to Medicare/Medicaid government agencies on this issue is *In Re Dartmouth House Nursing Home, Inc., et al*, 24 B.R. 256 (Bankr. D. Mass. 1982), which was premised on a major factual error, *to wit*, the assumption that each twelve month provider agreement is a separate executory contract (contra *Monsour*) and that the sole remaining obligation of the Medicaid agency after expiration of a twelve month provider agreement "is to correlate . . . rates, which is simply a ministerial and mathematical determination, which does not rise to the level of an executory obligation." 24 B.R. at 260 (i.e. the *Dartmouth* court's major factual error was its failure to recognize that the essence of the consideration for a state Medicaid agency is that

payments made in fact were used for patient care and not misappropriated).

Besides Judge Krechevsky, the only bankruptcy court to review *Dartmouth* rejected its reasoning as unpersuasive. *In Re Ambulance Corporation of America*, 27 B.R. 910, 912 (Bankr. E.D. Penn. 1983).*

The rational given by Judge Krechevsky for not following *Monsour, Berger* and *Yonkers* is twofold.

First, he cites the recent non-Medicare/Medicaid U.S. Supreme Court bankruptcy case of *N.L.R.B. v. Bildisco and Bildisco*, U.S. , 104 S. Ct. 1188, 79 L. Ed. 2d 482, 52 U.S.L.W. 4270 (1984) as, in effect, reversing *Yonkers* and rendering the provider agreement/executory contract unforceable because in *Willington* the provider agreement had neither been rejected nor assured.

However, in *Bildisco*, the debtor filed in Chapter 11 on April 14, 1980; refused to pay wage increases called for in the collective bargaining agreement in May, 1980 (giving actual notice by its conduct of unwillingness or inability to assume the executory contract); moved the Bankruptcy Court for permission to reject the collective bargaining agreement in December, 1980; and received such permission from the Bankruptcy Court on January 15, 1981. *Bildisco, supra* at 4271-4272.

In contrast, in *Willington*, the debtor filed in Chapter 11 on June 2, 1982; continued to participate as a nursing home provider in the Connecticut Medicaid Program and to receive monthly payment checks from the State until the facility

* Please note that while the *Ambulance* Court referred to the *Dartmouth* decision as *Massachusetts v. Erlin Manor Nursing Home*, this is in fact the *Dartmouth* decision found at 24 B.R. 256 (Erlin was the second named nursing home in that case, while Dartmouth was the first party in the same case).

closed in the Spring of 1983; *and never requested permission of the Bankruptcy Court to reject its provider agreement* during the entirety of its Chapter 11 proceeding (the case was converted to Chapter 7 on July 27, 1983).

While the *Bildisco* court noted that a Chapter 11 debtor has "more latitude *in deciding* whether to reject a contract . . ., *Bildisco, supra* at 4275 (emphasis added), in *Willington* the nursing home debtor *never decided* to reject and by its day-to-day conduct indicated just the opposite. In view of the factual differences between *Willington* and *Bildisco*, Appellants believe that *Yonkers* and not *Bildisco* is the appropriate case law authority.

Also, the very language Judge Krechevsky quoted from *Bildisco* states in part: "If the debtor-in-possession elects to continue to receive benefits from the other party to an executory contract pending a decision to reject or assume the contract, the debtor-in-possession is obligated to pay for the reasonable value of those services, *which, depending on the circumstances of a particular contract, may be what is specified in the contract . . .*" Memorandum and Order at p. 21 *quoting Bildisco, supra* at 4275.

Appellants contend that a Medicaid provider agreement is a classic example where "reasonable value" has to include the subsequent field auditing and recoupment provisions of the contract because, absent that, there is no mechanism to determine what in fact was spent on patient care. Again, the essence of the consideration for the State Medicaid agency is that Medicaid payments made to the nursing home were in fact used for the care of Title XIX Medicaid patients.

The second basis given by Judge Krechevsky for his decision in this issue is that, even if the provider agreement terms were enforceable without formal assumption, Connecticut's right to recover past Medicaid overpayments out of amounts due for March, 1983 services is a setoff and not recoupment right because defendant's right of recovery and plaintiff's

right of payment do not relate to the same subject matter. (Memorandum and Order at p. 22-23)

Appellants contend that this second basis is contrary to settled bankruptcy law not even arguably affected by *Bildisco*. For recoupment of past Medicare/Medicaid overpayments from current payments to providers is "merely an arrival at a just and proper liability on the main issue" arising out of the same transaction (i.e., the nursing home provider — Medicare/Medicaid agency ongoing relationship) *4 Collier on Bankruptcy*, ¶ 553.03, at 553.12 (15th Ed. 1981) *as quoted in Yonkers, supra* at 432, 433, and therefore is a right of recoupment and not a setoff. *Yonkers, supra.*

Judge Krechevsky then concludes that concerning the aforesaid right to recover versus right of payment, "neither relate to the same subject matter [contra *Yonkers*] nor arise from the same contract [contra *Monsour*, 8 B.R. at 613 *aff'd* 11 B.R. at 1017]"

Appellants respectfully submit that Judge Krechevsky erred in his holding on this issue and respectfully suggest that the reason for the error was his attempt to force non-Medicare/Medicaid bankruptcy cases into a *sui generis* area of Medicare/Medicaid bankruptcy law.

C. EVEN ASSUMING *ARGUENDO* JUDGE KRECHEVSKY'S VIEWS THAT A STATE MEDICAID AGENCY'S RECOUPMENT RIGHT IS ONLY A SETOFF RIGHT AND HIS READING OF *BILDISCO*, THE BANKRUPTCY COURT STILL ERRED IN HOLDING SUCH "SETOFFS" CONTRARY TO BANKRUPTCY LAW.

Even assuming *arguendo* that Judge Krechevsky was correct in viewing a State Medicaid agency's recoupment right as a setoff and was correct in his reading of *Bildisco*, Appellants contend that he still erred in holding such "setoffs" contrary to federal law and unenforceable, when the bankruptcy

case of *In Re Ambulance Corporation of America*, 27 B.R. 910 (Bankr. E.D. Penn 1983) held that post-petition setoff of prepetition Medicare overpayments against currently due Medicare reimbursement to a debtor in bankruptcy *was consistent with bankruptcy law* until a bankruptcy court order *after adequate protection of the government's interest was entered. Ambulance, supra* at 912.*

It is undisputed that in *Willington* no bankruptcy order of adequate assurance to Appellants' interest was ever entered.

* * *

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* The *Ambulance* Court expressly held: "It is undisputed the Defendants are authorized to setoff past overpayments against reimbursements currently due under the Medicare program . . . This right of setoff is preserved under the Bankruptcy Code. 11 U.S.C. § 553. A party with a right of setoff may retain funds until the issue of the propriety of setoff is decided. 11 U.S.C. § 542(b).

Under the Bankruptcy Code, a right of setoff is treated as a secured claim. 11 U.S.C. § 506(a). Furthermore, the debtor's right to reimbursement constitutes "cash collateral" under the Code. 11 U.S.C. § 363(a). Although these funds, if reimbursed, are collateral of a nature which could be used by the debtor,[3] cash collateral may not be used by the debtor unless there is consent of the secured party or pursuant to a court order. 11 U.S.C. § 362(c)(2). If the Court were to permit the debtor to use this cash collateral, the interest of the Defendants would have to be adequately protected. 11 U.S.C. § 363(e)." *Ambulance, supra* at 911-912.

*** authority for the specific fact pattern and procedural posture of the *Willington* adversary proceeding here on appeal, i.e., a 28 U.S.C. § 1471(b) "related to" adversary proceeding seeking past contractual money damages from state agencies.

If the *entirety* of 11 U.S.C. § 106, its legislative history and case law are to have consistent and harmonious meaning, then on this specific fact pattern and procedural posture, Connecticut's Sovereign Immunity is a jurisdictional defense to the *Willington* adversary proceeding at bar.

IV. THE STATE MEDICAID AGENCY'S RIGHT TO RECOUP PAST MEDICAID OVERPAYMENTS FROM THE MONTHLY MEDICAID PAYMENT CHECKS TO A NURSING HOME DEBTOR.

A. FACTUAL MISUNDERSTANDING OF MEDICAID RATE LAW BY APPELLEE AND JUDGE KRECHEVSKY.

Both Appellee and Judge Krechevsky viewed this issue as an everyday run of the mill creditor-debtor dispute where the latter has filed in bankruptcy and therefore refused to follow the five (5) bankruptcy decisions specifically governing this issue.

Without reiterating Appellants factual and legal statement of the Medicaid Cost Related Reimbursement System (which are undisputed in this case), one major example of the factual misunderstanding of the Medicaid Program by both Appellee and Judge Krechevsky should be raised.

For while neither one questions the fact that the per diem rate of a nursing home is computed by the State taking the nursing home's word for whatever costs it claims, both would invoke the bankruptcy automatic stay to stop field auditing to verify these cost claims and recoupment of monies illegally

received* and would further argue that the State must pay the debtor the "reasonable value" of services it renders.

But, given the fact that each nursing home *has its own individual Medicaid rate* based upon the costs it claims, what is the "reasonable value?" The Trustee wants to multiply the number of patient days times the nursing home's Medicaid rate. But under his view that the bankruptcy automatic stay stops field auditing and recoupment, that rate would include the unallowable costs and be inflated and perhaps fraudulent. That's "reasonable value?" No, it is not. Whether the Trustee realizes this or not, if his theory prevails the Bankruptcy Code would be misused to aid and abet Medicaid fraud (as providers could fill their annual reports with unallowable cost claims, collect resultant increased Medicaid rates and just file in Chapter 11 when the State's field auditors appear).

B. APPELLEE'S ATTEMPT TO DISTINGUISH THE BANKRUPTCY CASE LAW AUTHORITY UPHOLDING THE STATE MEDICAID AGENCY'S RIGHT OF RECOUPMENT IS WITHOUT MERIT.

While the Appellee is correct in pointing out that in the *Monsour* case there was formal assumption of the provider agreement (Appellee's Appeal Brief at p. 15), the *Yonkers* case expressly rejected that distinction where the health care facility continues with the provider agreement after filing in bankruptcy (see Appellants' Appeal Brief at p. 51–52).

Indeed, the *Yonkers* fact pattern was virtually identical to the *Willington* fact pattern in the case at bar. Both providers had received past Medicare/Medicaid overpayments from the government (discovered by field audits); both providers filed in Chapter 11 and had modest monthly recoupment of said debts from their periodic payment checks; and both debtors subsequently converted to Chapter 7 and had their trustees sue the government over said recoupments. See

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* Absent formal assumption of the provider agreement.

22 B.R. at 429. Contrary to Appellee's statements at p. 15-16 of his Appeal Brief, the *Willington* debtor also was aware of and acquiesced in the post-petition recoupment* as evidenced by the undisputed fact that it was only after to conversion of the Willington case from Chapter 11 to Chapter 7 and the appointment of Mr. Hoffman as trustee that any adversary proceeding against Appellants was initiated.

Other than said futile attempt to distinguish *Monsour* and *Yonkers*, Appellee stands silent on the merits of the holdings of the two (2) *Monsour* decisions, *Berger*, *Yonkers* and *Ambulance* (See Appellants' Appeal Brief at p. 50-53), which authorize the recoupment at issue here.

C. NOTWITHSTANDING *BILDISCO*, *YONKERS* REMAINS THE APPLICABLE BANKRUPTCY CASE LAW AUTHORITY WHERE A NURSING HOME DEBTOR ELECTS TO CONTINUE POST-PETITION PARTICIPATION IN THE MEDICAID PROGRAM.

Appellants stand on p. 53-55 of their Appeal Brief. *Bildisco* is a factually distinguishable non-Medicare/Medicaid bankruptcy case. *Yonkers* continues to be the Medicare/Medicaid bankruptcy authority.

In the alternative, even *Bildisco*, as applied to circumstances such as in *Willington* would have to view "reasonable value" as "what is specified in the contract" (i.e., to include field auditing and recoupment to insure that the rates paid were in fact for patient care and were not illegally diverted. Otherwise there would be no mechanism whatsoever to determine what constitutes "reasonable value."

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* For example, in August of 1982, pursuant to an oral agreement with the *Willington* debtor, the amount of monthly recoupment was substantially reduced.

D. APPELLANTS' REPAYMENT RIGHT IS IN RECOUPMENT, NOT SETOFF, SINCE RECOUPMENT OF PAST MEDICAID OVERPAYMENTS ARISING OUT OF THE SAME TRANSACTION — THE NURSING HOME/MEDICAID AGENCY ONGOING RELATIONSHIP.

In his Appeal Brief at p. 14 all the Trustee did was to refer only to the authority cited by Judge Schwartzberg in *Yonkers* on this issue (22 B.R. at 432, 433) and by Appellants at p. 56 of their Appeal Brief *and then reverse the legal conclusion.*

Appellants believe that Judge Schuartzberg correctly ruled that the government's statutory and regulatory authority to recoup past Medicard overpayments "codify the government's common law right of recoupment," *Yonkers*, 22 B.R. at 433, and that such recoupment is "merely an arrival at a just and proper liability on the main issue" arising out of the same transaction (i.e., the health care provider — Medicare/Medicaid agency ongoing contractual relationship). 4 *Collier on Bankruptcy*, ¶ 553.03 at p. 553-12 *as quoted in Yonkers*, 22 B.R. at 432, 433.

It has been previously established and affirmed that a series of Medicare provider agreements *constitute one, ongoing executory contract. Monsour*, 8 B.R. at 613, *aff'd.* 11 B.R. at 1017.

Settled bankruptcy law on this issue contradicts both Judge Krechevsky and the Trustee.

E. REGARDLESS OF *BILDISCO* AND THE RECOUPMENT VERSUS SETOFF ISSUE, JUDGE KRECHEVSKY STILL ERRED IN HOLDING APPELLANTS' "SETOFFS" CONTRARY TO BANKRUPTCY LAW.

At p. 16-17 of his Appeal Brief, the Trustee irrelevantly argues the general rule of bankruptcy law, that prepetition debts may not be set off against postpetition claims.

Appellants do not argue that this is the general rule in non-Medicare/Medicaid continuing provider agreement situations.*

The Trustee's citation of Code § 553(a), Collier, *Hill* and *Energy Co-op* refer to said general rule and are irrelevant to the fact pattern at bar. The *Howell* case refers to a Chapter 13 debtor' disability benefits directly received from the Social Security Administration and is impacted by the legislative history of Code § 101(24) concerning such benefits. 4 B.R. at 106. The *Neavear* case also involves such Social Security disability benefits and is *wrongly cited* by the Appellee as concerning past Medicaid overpayments. Finally, the very proposition for which the Trustee cites *Dartmouth* (a state's claim to past Medicaid overpayments has the characteristics of an antecedent unsecured claim) was subsequently expressly rejected by the *Ambulance* bankruptcy court ("This Court, however, is not persuaded by the reasoning expressed therein. *We do not believe that the relationship between the parties in this case can be characterized merely as that of a debtor and an unsecured creditor.*" 27 B.R. at 912 (emphasis added).

• • •

But even assuming *arguendo* Judge Krechevsky's reading of *Bildisco* and his setoff instead of recoupment holding, he still erred in then holding such "setoffs" contrary to bankruptcy law and unenforceable. 27 B.R. at 912.

P. 56-57 of Appellants' Appeal Brief set forth with specificity a discussion of the *Ambulance* case and said bankruptcy court's statutory analysis of the Bankruptcy Code, concluding that postpetition setoff of prepetition Medicare overpayments against currently due Medicare reimbursement to a

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* As discussed at p. 50-53 of Appellants' Appeal Brief, five (5) of the six (6) bankruptcy decisions on this issue came down on the side of the recoupment right of the Medicare/Medicaid agency. The sixth case (*Dartmouth*) (cited by the Appellee at p. 17 of his Appeal Brief) was wrongly decided based on a major factual error and was subsequently rejected by the *Ambulance* Court.

debtor in bankruptcy *was consistent with bankruptcy law* until a bankruptcy court order *after adequate protection of the government's interest was entered.* 27 B.R. at 912.

It is undisputed that in *Willington* no such order of adequate protection to Appellants' interest was ever entered.

Appellee's total silence on this point is of great significance. Indeed, Judge Krechevsky's citation of *Ambulance* in his Memorandum and Order but failure to respond at all to this holding is also most noteworthy.

V. THE BANKRUPTCY COURT ERRED IN DENYING THE FAILURE TO EXHAUST ADMINISTRATIVE REMEDIES AND FULL FAITH AND CREDIT GROUNDS OF THE MOTION TO DISMISS.

In our Appeal Brief, Appellants called to the attention of the District Court that these (2) separate and independent jurisdictional grounds of the Motion to Dismiss were not contested by the Trustee and were denied by Judge Krechevsky with no legal basis for such denial presented in his Memorandum and Order.

Appellants contend in this appeal that this was arbitrary and capricious.

RELEVANT DOCKET ENTRIES
Edward Zera

1-05-84 Complaint filed by Trustee.

2-21-84 Defendant's Motion to Dismiss.

2-21-84 Memorandum In Support of Defendant's Motion to Dismiss.

4-26-84 Plaintiff's Memorandum in Opposition to Defendant's Motion to Dismiss.

5-09-84 Defendant's Reply Memorandum to Plaintiff's Memorandum In Opposition to Motion to Dismiss.

5-11-84 Parties' Consent to Entry of Judgment or Dispositive Order by a United States Bankruptcy Judge.

6-08-84 Memorandum & Order Denying Motion to Dismiss, MD sent copies to: Martin Hoffman, Esq., Jonathan Ensign, Esq.

6-15-84 Notice of Appeal by State of Ct., Dept. of Rev. Serv., Defendant, on Mem. & Order dated 6/8/84 Denying Motion to Dismiss.

6-20-84 Notice of Cross-Appeal by Martin W. Hoffman, Plaintiff.

7-30-84 Record on appeal (copies) received from Bankruptcy Office. Appeal is on Memorandum and Order of Bankruptcy Judge in which court denied Plaintiff's claim.

8-27-84 Brief of the Cross-Appellant filed, Martin Hoffman.

9-19-84 Brief of the Appellant and Cross-Appellee.

11-05-84 Brief of the Appellee and Cross-Appellant, filed.

11-13-84 Reply Brief of Appellant filed.

6-18-85 Certification Order Pursuant to 28 U.S.C. Sec. 2403(b) "Atty. General to report intervention on or by 7-19-85." Dorsey, J. — cc mld (LW).

9-27-85 Motion for Intervention of the United States fld (LW).

10-10-85 END on Dckt no. 13 "GRANTED." Dorsey, J. — cc mld (LW).

5-11-87 Memorandum of Decision (Accordingly, the order of the bankruptcy court dismissing Revenue's mot. to dismiss is reversed and the case is remanded to that court for the purpose of dismissing the action against Revenue.) Dorsey, J. — cc mld (LW) M. 5/12/87

6-04-87 Notice of Appeal from Order of Reversal. Fee paid. Civil Management Plan and Forms C & D handed to appellant's atty. Certified copy of notice and docket sheet mld to USCA; copies to counsel (CB).

6-08-87 Copy of district court docket entries and notice of appeal on behalf of the appellant Martin W. Hoffman, Trustee, filed.

10-09-87 Appellant Martin W. Hoffman, Trustee brief filed w/pfs.

10-09-87 Appellant Martin W. Hoffman, Trustee appendix filed w/pfs.

11-09-87 Appellee Connecticut Dept. of Income Maintenance (sic) briefs filed w/pfs.

11-13-87 Intervenor-Appellee USA brief filed (w/pfs).

11-23-87 Appellant Martin W. Hoffman, Trustee reply brief filed w/pfs.

1-27-88 Case heard before Oakes, Newman, Miner,, C.JJ.

6-15-88 Judgment Affirmed by published signed opinion per Judge Miner (original filed in 87-5021) Judgment Filed.

Chapter 7 Proceeding No. 2-83-00754
Adversary Proceeding No. 2-84-0008

UNITED STATES BANKRUPTCY COURT
DISTRICT OF CONNECTICUT

EDWARD ZERA fdba
Debtor

MARTIN W. HOFFMAN, TRUSTEE
Plaintiff

v.

STATE OF CONNECTICUT,
DEPARTMENT OF REVENUE SERVICES
Defendant

COMPLAINT

(dated January 4, 1984)

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1. This is an action to set aside, pursuant to 11 U.S.C. Sec. 547, a preference made by the Debtor to the Defendant herein and to recover the value of said transfer for the benefit of the estate in accordance with 11 U.S.C. Section 550.

2. Jurisdiction is conferred on this Court by 11 U.S.C. Section 105 and 28 U.S.C. Section 1471.

3. On October 7, 1983, the above-named Debtor filed a Chapter 7 Proceeding, and on October 11, 1983, Martin W. Hoffman, Esq. was appointed Trustee of said Estate.

4. The Defendant, Department of Revenue Services, has an address of 92 Farmington Avenue, Hartford, CT.

5. Within 90 days of the filing of the petition seeking relief, the Defendant received payment from funds of the Debtor totaling $2,100.62.

6. Said transfer of $2,100.62 constitutes a voidable preference within the meaning of Section 547 of the Bankruptcy Code for the reasons that:

a. the transfer was to or for the benefit of Defendant who was a creditor of the debtor;

b. the transfer was for or on account of an antecedent debt owed by the Debtor before said transfer was made;

c. the transfer was made while the debtor was insolvent;

d. the transfer was made within 90 days before the date of the filing of the petition; and

e. the transfer enabled the creditor to receive more than any other creditor of the debtor.

7. Demand for the turnover of the funds has been made and refused.

WHEREFORE, Plaintiff demands judgment, setting aside the transfer as preferential and that judgment be entered in favor of the Plaintiff against the Defendant in the amount of Two Thousand One Hundred and 62/100 (2,100.62) Dollars and costs.

Dated at Hartford, Connecticut, this 4th day of January, 1984.

PLAINTIFF:
Martin W. Hoffman, Trustee

By /s/ Martin W. Hoffman

Martin W. Hoffman
Attorney for the Trustee
410 Asylum Street
Hartford, CT 06103

UNITED STATES BANKRUPTCY COURT
DISTRICT OF CONNECTICUT

(Caption omitted in printing)

MOTION TO DISMISS

(February 21, 1984)

The defendant hereby moves the Court, pursuant to Rules 12(b)(1) and 12(b)(6) of the Federal Rules of Civil Procedure and Bankruptcy Rule 7012, 11 U.S.C., to dismiss this action for the following reasons:

1. The Complaint fails to demonstrate the jurisdiction of this Court in law or in fact.

2. The Complaint fails to state a claim upon which relief can be granted.

THE DEFENDANT

BY: JOSEPH I. LIEBERMAN
ATTORNEY GENERAL

/s/ Jonathan L. Ensign

Jonathan L. Ensign
Assistant Attorney General
P.O. Box 120
Hartford, CT 06101
Tel. (203) 566-4899

(Certificate of Service omitted in printing)

*** section 547(b), the Court of Appeals concluded that Congress intended for this action to be brought in federal court. *Id.* at 327.

Section 542(b) contains the word "entity", which also triggers section 106(c)'s waiver of sovereign immunity. Thus, the Plaintiff may assert a cause of action against the Defendant based on section 542(b) notwithstanding sovereign immunity. Congress granted the Bankruptcy Court jurisdiction over an action under section 542(b) when it enacted 28 U.S.C. § 1471. Therefore, Congress clearly abrogated the Defendant's Eleventh Amendment immunity with respect to the Plaintiff's suit.

IV. WHETHER 11 U.S.C. § 553 PRECLUDES THE DEFENDANTS FROM SETTING OFF THE POST-PETITION DEBT IT OWES TO THE ESTATE AGAINST ITS PREPETITION CLAIM

A. The Defendant's claim is one in setoff, not recoupment, since the claim arises from a different transaction than the Plaintiff's cause of action.

The District Court erroneously held that the State of Connecticut had the right to recoup prepetition overpayments made to the Debtor by withholding funds for services performed by the Debtor post-petition. *Willington*, 72 B.R. at 1012. The State of Connecticut, however, has only a right to setoff under its contract with the Debtor, not a right of recoupment.

The distinction between recoupment and setoff is crucial in a bankruptcy context. A creditor's right to setoff under the Bankruptcy Code applies only to mutual debts incurred by debtor and creditor before the commencement of a case under

the Code. See 11 U.S.C. § 553(a).[5] There is no Code provision expressly governing recoupment, however.

The key distinction between recoupment and setoff is that the former arises from the same transaction as the plaintiff's claim and the latter from a distinct transaction. 4 *Collier on Bankruptcy*, § 553.03 at 553-12 (15th ed. 1984). In the instant case, the State seeks to recover alleged overpayments under Medicaid contracts for the years 1976-1980 against a debt owed to the Debtor arising from services provided after the Debtor filed under Chapter 11. As the Bankruptcy Court in this case noted the parties' respective claims "neither relate to the same subject matter nor arise from the same contract." *Willington*, 39 B.R. at 792. Hence, the State's claim must be characterized as one in setoff rather than recoupment.

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[5] 11 U.S.C. § 553(a) provides:

(a) Except as other provided in this section and in sections 362 and 263 of this title, this title does not affect any right of a creditor to offset a mutual debt owing by such creditor to the debtor that arose before the commencement of the case under this title against a claim of such creditor against the debtor that arose before the commencement of the case, except to the extent that —

(1) the claim of such creditor against the debtor is disallowed other than under section 502(b)(3) of this title;

(2) such claim was transferred, by an entity other than the debtor, to such creditor —

(A) after the commencement of the case; or

(B) (i) after 90 days before the date of the filing of the petition; and (ii) while the debtor was insolvent; or

(3) the debt owed to the debtor by such creditor

(A) after 90 days before the date of the filing of the petition;

(B) while the debtor was insolvent; and

(C) for the purpose of obtaining a right of setoff against the debtor.

11 U.S.C. § 553 (1987).

B. Since under the Bankruptcy Code a creditor may not set off a post-petition claim or debt owed to the estate against a pre-petition claim or debt owed to the estate, any sum that might be owing to the State for alleged Medicaid overpayments has the status of an antecedent unsecured debt.

11 U.S.C. § 553(a), governing a creditor's right to setoff against a debtor does not apply where a creditor attempts to set off a pre-petition debt or claim against a debt or claim of the estate arising after the filing of a bankruptcy petition. 4 *Collier on Bankruptcy* § 553.10(1) at 553-49 (15th ed. 1984).

The reason that the right of setoff under the Bankruptcy Code is limited to transactions arising before the commencement of a bankruptcy case is to preserve the element of mutuality of obligation. 4 *Collier* at 553.10(1). To permit creditors to offset pre-petition debts from post-petition obligations would be to allow them to unilaterally deplete the resources available to the debtor to satisfy all creditors. *In Re Hill*, 9 B.C.D. 53 at 55 (Bankr. N.D. Tex. 1982); *In Re Energy Co-Op, Inc.*, 32 B.R. 680 at 684 (Bankr. N.D. Ill. 1983). It is clear that payments due to a debtor-in-possession under an executory contract are property of the estate. *In Re Howell*, 7 B.C.D. 1 at 3 (Bankr. M.D. Tenn. 1980). Whatever claim the Defendants may assert to alleged past Medicaid overpayments has the characteristics of an antecedent unsecured debt. *In Re Dartmouth House Nursing Home*, 9 B.C.D. 954 at 956 (Bankr. Mass. 1982); *In Re Nevear*, 9 B.C.D. 132 (7th Cir. 1982). Of course, a full determination of the status of the Defendant's claim awaits the Bankruptcy Court's review of the merits of the instant case.

C. Whether the provider agreements between the Debtor and the State are considered separate agreements of a single executory contract, they are unenforceable against the Debtor.

As the Bankruptcy Court noted in its Memorandum and Order, even if the past Medicaid provider agreements between

the Defendants and the Debtor are considered part of a single executory contract, they are unenforceable against the Debtor absent their formal assumption by the Debtor. *Willington*, 39 B.R. at 791. In *NLRB v. Bildisco & Bildisco*, 465 U.S. 513, 104 S.Ct. 1188, 79 L.Ed.2d 482 (1984), Justice Rehnquist found that an employer was not bound to comply with the terms of an executory collective bargaining agreement after the commencement of Chapter 11 proceedings but before formal assumption or rejection of the contract, "since the filing of a petition in bankruptcy under Chapter 11 makes the contract unenforceable." 104 S.Ct. at 1200.

Bildisco does not hold for the proposition that a debtor-in-possession may accept the benefits of a contract without incurring corresponding obligations. Pending formal assumption or rejection of the contract, the debtor is "obligated to pay for the reasonable value" of services rendered to it by the other parties to the agreement. 104 S.Ct. at 1199. In the instant case, the Debtor fulfilled its part of the bargain by performing the services required of it under the Medicaid provider agreement. It is the Defendants who have denied the Debtor compensation for the reasonable value of its services, and who claim that the Debtor should further be denied a right of action to recover that compensation.

(Pages 6–13 of Connecticut's Brief of the Defendants-Appellees dated November 6, 1987)

*** preceeding month), in part recovering the $10,000.00 extraordinary post-petition advance.

Although Willington still owed the State $121,408.82 in past Medicaid overpayments, the Department of Income Maintenance did not file any proof of claim in the Willington bankruptcy case as the agency scrupulously avoided doing anything that could be argued to waive either its Sovereign Immunity or its Eleventh Amendment Immunity.

On July 27, 1983, the Bankruptcy Court converted the Willington bankruptcy case from Chapter 11 to Chapter 7 and appointed a Trustee. The Trustee on January 3, 1984 filed a Complaint for Money Damages Adversary Proceeding against the State under the 28 U.S.C. § 1471(b) "related" jurisdiction. Contrary to the Trustee's brief, it was *not* a turnover petition pursuant to 11 U.S.C. § 542(b). The only relief sought was past contractual money damages from a state agency in a federal court. (Appendix, hereinafter "App.", p. A-6).

The State concurs with the Trustee's recitation of the subsequent procedural sequence of events which took place in the bankruptcy and district courts, which culminated in the District Court granting the State's Motion to Dismiss.

ARGUMENT

I. THE BANKRUPTCY LAW DOCTRINE OF RECOUPMENT ENTITLED THE STATE MEDICAID AGENCY TO RECOUP PAST MEDICAID OVERPAYMENTS DETECTED BY THE FIELD AUDIT OF DEBTOR NURSING HOME'S COST CLAIMS.

A. The Factual Findings of the District Court and Connecticut State Law Establish That the Doctrine of Recoupment Governs in this Case Because the Nursing Home Submission of Cost Claims to the State Medicaid Agency and the Field Auditing of Same Constitute One Transaction.

The District Court entered specific factual findings at App., p. A-84 to A-86 and A-103 that:

1. The debtor nursing home voluntarily contracted with the State to participate in the Connecticut Medicaid Program (App., p. A-84);

2. That the contract provided for computation of the annual per diem rate of payment on the basis that Willington would submit cost data which the State would accept at face value *subject to* subsequent field audits to verify that the costs claimed are legitimate (App., p. A-84);

3. That the contract further provided that if costs are found to have been improperly claimed, the State would adjust the per diem rate retroactive to the applicable rate year *and recoup the amount of Medicaid overpayment from whatever monthly payments may be due and owing to the facility for current patient care* (App., p. A-84);

4. That a field audit of Willington's cost reports discovered that the debtor had falsely claimed real property costs of $294,007 which were only allowable in the amount of $22,500 (App., p. A-85); and

5. That the contract between Willington and the State entitled Connecticut to recoup past Medicaid overpayments to Willington for services rendered after filing in bankruptcy (App., p. A-103).

Thus, the District Court made factual findings that the debtor and the State contracted on the basis that the final correct per diem rate of payment would only be determined post-field audit. Further, both Connecticut State law[10] and the contract itself specifically provided for "recoupment" when a field audit detected past false cost claims and resulting overpayments. Thus, when Willington and the State entered into their contractual relationship, both parties intended recoupment to govern in the Medicaid rate computation and verification process. They further intended that the filing of cost claims and the verification of same was part and parcel of one single transaction.

That the relationship between Willington and the State Medicaid agency was one continuous transaction is further established by Conn. Gen. Stat. § 19a-154, which requires that the State grant permission for a nursing home to leave the Connecticut Medicaid Program.

B. Case Law on Recoupment Versus Setoff

Without even reaching the numerous and complex issues *infra* involving the interrelationship of the Eleventh Amendment, Sovereign Immunity and the Bankruptcy Code, the District Court can and should be easily affirmed on its alternative holding "that the terms of Willington's contract with Connecticut entitled the state to recoup past overpayments to Willington . . ." App., p. A-103.[11]

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[10]Regulations of Connecticut State Agencies § 17-311-53.

[11]Rather than discuss the applicable law on this issue, the District Court incorporated by reference the Brief and Reply Brief which Connecticut had submitted to the District Court. App., p. A-103. In the event that the Second Circuit deems it helpful to review said pages, they are at S.App., p. SA-8 to SA-26.

When this issue was briefed for the District Court in 1984, four of the five bankruptcy cases then in existence held in favor of the right of the Medicare/Medicaid agency to recoup overpayments from providers notwithstanding their filing in bankruptcy. *In Re Monsour Medical Center*, 8 B.R. 606 (Bankr. W.D. Pa. 1981), *aff'd* 11 B.R. 1014 (W.D. Pa. 1981); *In Re Berger*, 16 B.R. 236 (Bankr. S.D. Fla. 1981); *In Re Yonkers Hamilton Sanitarium, Inc.*, 22 B.R. 427 (Bankr. S.D.N.Y. 1982), *aff'd* 34 B.R. 385 (S.D.N.Y. 1983); *In Re Ambulance Corporation of America*, 27 B.R. 910 (Bankr. E.D. Pa. 1983). *Contra: In Re Dartmouth House Nursing Home, Inc.*, 24 B.R. 256 (Bankr. Mass. 1982)[12]

Bankruptcy case law on this issue has since developed further to include recognition by both the Third and Tenth Circuits of the government's overpayment recoupment right against health care providers notwithstanding bankruptcy. See *Lee v. Schweiker*, 739 F.2d 870, 875–876 (3rd Cir. 1984); *In Re B & L Oil Co.*, 782 F.2d 155, 157 (10th Cir. 1986).

In *Lee v. Schweiker, supra*, the Third Circuit discussed the doctrines of "setoff" and "recoupment," which doctrines have been both adopted in bankruptcy, setoff by statute and recoupment by decision. 739 F.2d at 875.[13] While "setoff" is limited to mutual, pre-petition claims against the creditor and is further limited by 11 U.S.C. § 553 (e.g., pre-petition claims against the debtor cannot be setoff against post-petition debts to the debtor),[14] "[r]ecoupment, on the other hand, allows the

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[12]The *Dartmouth* case was both wrongly decided (rejected by *Ambulance*, 27 B.R. at 912) and distinguishable due to the difficult rate system employed by Massachusetts which did in fact provide for rate setting *and* verification *in the same year*. See 24 B.R. at 258.

[13]See also *B & L Oil Co.*, 782 F.2d at 157; *In Re Nickerson & Nickerson, Inc.*, 62 B.R. 83, 87 (Bankr. D.Neb. 1986); *In Re American Cent. Airlines, Inc.*, 60 B.R. 587, 590 (Bankr. N.D. Iowa 1986).

[14]But even re "setoff", see *Ambulance*, 27 B.R. at 912 (Medicare-Medicaid agency can "setoff" pre-petition overpayment against a post-petition payment absent court order or adequate protection of the government).

creditor to assert that certain mutual claims extinguish one another in bankruptcy, in spite of the fact that they could not be 'setoff' under 11 U.S.C. § 553. The justification for the recoupment doctrine is that where the creditor's claim against the debtor arises from the same transaction as the debtor's claim, it is essentially a defense to the debtor's claim against the creditor rather than a mutual obligation, and the application of the limitations on setoff in bankruptcy would be inequitable. [citation omitted]." 739 F.2d at 875.[15]

The Third Circuit then specifically observed:

> "In bankruptcy, the recoupment doctrine has been applied primarily where the creditor's claim against the debtor and the debtor's claim against the creditor arise out of the same contract [citations omitted]. *In a number of cases involving the bankruptcy of health-care providers, the courts have allowed . . . [Medicare fiscal intermediaries] to 'recoup' overpayments from amounts owed to the debtor post-petition, under a contract providing for such recoupment* [citing *Monsour, Yonkers* and *Berger*] . . . The analysis used in these cases is based on the treatment of executory contracts in bankruptcy: *a debtor may not assume the favorable aspects of a contract (post-petition payments) and reject the unfavorable aspects of the same contract (the obligation to repay pre-petition overpayments by means of 'recoupment').*

The courts have generally taken a different approach in dealing with government benefits to individuals, such as social security. In these circumstances, the courts have held that a social-welfare statute entitling an individual to benefits is not a

[15] Indeed, it has been specifically held that the doctrine of recoupment is *not* subject to the setoff provisions of 11 U.S.C. § 553. *In Re Yonkers Hamilton Sanitarium, Inc., supra; In Re Alpco, Inc.*, 62 B.R. 184, 188 (Bankr. S.D. Ohio 1986).

> contract, and that the obligation to repay a previous overpayment is a separate debt subject to the ordinary rules of bankruptcy [citations omitted]. *We find the distinction persuasive.*" 739 F.2d at 875-876 (emphasis added).

Indeed, it has been held that where the doctrine of recoupment applies, "[t]here is no element of preference here or of an independent claim to be offset, but merely an arrival of a just and proper liability on the main issue, and this would seem permissible without any reference to . . . § 553(a)." *In Re McCoy*, 65 B.R. 673, 674 (Bankr. S.D. Ill. 1986) *citing 4 Collier on Bankruptcy*, ¶ 553.03 at 553.12 (15th Ed. 1981); *Yonkers, supra.*

See also *In Re American Cent. Airlines*, 60 B.R. at 590 (where the doctrine of recoupment governs, "the distinction between pre-petition and post-petition events does not apply"); *In Re Neuman*, 55 B.R. 702, 706 (S.D.N.Y. 1985) (with an excellent discussion of the government's comon law right to recoup Medicare overpayments from funds otherwise due to a health care provider codified both by statute and by regulation); *In Re Alpco, Inc.*, 62 B.R. at 187-188; *In Re Clowards*, 42 B.R. 627, 628 (Bankr. D. Idaho 1984).

C. Given Willington's Conduct in the Case, Equity Mandates Application of the Doctrine of Recoupment.

As the Tenth Circuit has observed, bankruptcy courts apply recoupment as an equitable doctrine to avoid unjust enrichment of the debtor or a windfall to his other creditors. *B & L Oil*, 782 F.2d at 159.

This appeal is a classic case of where equity mandates application of the doctrine of recoupment. For here, the debtor submitted false cost claims of $294,007 in historical property costs (actually only allowable in the amount of $22,500) and for five years illegally pocketed valuable scarce taxpayer dollars set aside for the care of indigent, medically needy, Title

XIX Medicaid patients. App., p. A-84. When caught by the auditors and its rates appropriately recomputed in 1982, the debtor promptly filed its operating corporation in bankruptcy to evade its recoupment obligation, App., p. A-86, but kept out of the bankruptcy the nursing home building and realty, which the debtor's owners sold and personally pocketed the proceeds.

The Trustee argues that "*[i]t is clear* that payments due to a debtor in possession under an executory contract are property of the estate." Brief 26 (emphasis added). It is, in fact, not clear. In *In Re American Cent. Airlines*, the bankruptcy court held that the "interest that the bankruptcy estate acquire[s] in the post-petition subsidy payments is subject to DOT's right to recoup." 60 B.R. at 592. It has been specifically held that Medicaid providers "have no vested property interest in retaining . . . [past Medicaid] overpayments." *St. Joseph Hospital v. Electronic Data Systems Corp.*, 573 F.Supp. 443, 447 (S.D. Tex. 1983).[16]

In any event, it is undisputed that, even after its filing in bankruptcy on June 2, 1982, Willington chose to continue its participation in the Connecticut Medicaid Program and continued to receive monthly Medicaid payment checks until it closed in April, 1983. App., p. A-86. Indeed, in August, 1982, Willington even negotiated an agreement with the State to reduce the monthly rate of recoupment.

Thus, even though Willington never submitted its provider agreement for either assumption or rejection, its above-discussed undisputed conduct constituted assumption of the executory contract. See *In Re Reda, Inc.*, 54 B.R. 871, 880, 881 (Bankr. N.D.Ill. 1985) (Although there was no formal

[16]The *St. Joseph* Court went on to note that "the funds at issue do not even 'belong' to the providers under any circumstances . . . The public interest factor strongly militates against the hospital's position since the public has a very strong interest in promptly recovering a debt . . . that has been due for several years. (One must bear in mind that the monies at issue here represent tax dollars)." 573 F.Supp. at 448-449.

assumption by the debtor, the court found that the debtor's actions constituted acceptance of the executory contract, holding that the debtor was responsible for the benefits and burdens of the contract); *In Re Midwest Services & Supply Co., Inc.*, 44 B.R. 262, 265 (D. Utah, C.D. 1983).

Indeed, Bankruptcy Judge Schwartzberg of the Southern District of New York has expressly rejected the argument that recoupment could not be effected because the provider agreement had neither been assumed nor rejected, holding:

> "It does not follow, however, that if neither party to an executory contract . . . takes any action with respect to assumption or rejection, the contract has no significance. As long as the debtor continues to receive benefits under such contract it must also bear the burdens or obligations imposed under the contract. [citations omitted]. the *Monsour* and *Berger* cases are consistent with this principle *and were not incorrectly decided*, as the Trustee's counsel contends. *Yonkers*, 22 B.R. at 435 (emphasis added).[17]

The Trustee relies on *N.L.R.B. v. Bildisco and Bildisco*, 465 U.S. 513, 104 S.Ct. 1188, 79 L.Ed.2d 482 (1984) for his argument that the Willington provider agreement was unenforceable because it was not assumed. However, in *Bildisco there was no recoupment issue at all*,[18] and the debtor there gave notice by its conduct of its unwillingness or inability to comply with its collective bargaining agreement and then

[17]On appeal, the *Yonkers* district court affirmed, stressing the inequity which would result if the provider could evade the burden of recoupment of past overpayments after having accepted the benefit of the executory contract (provider agreement) in the form of continued Medicare funding. 34 B.R. at 388.

[18]Because, as demonstrated *supra*, the doctrine of recoupment, where applicable, is part of federal bankruptcy law, it is irrelevant whether or not the contract was assumed or rejected. In any event, as demonstrated *supra*, the *Willington* debtor by its conduct after filing in bankruptcy assumed its provider agreement.

actually moved and obtained the permission of the bankruptcy court to reject that agreement. 104 S.Ct. at 1192.

While the *Bildisco* Court noted that a Chapter 11 debtor has "more latitude *in deciding* whether to reject a contract . . ." *Bildisco*, 104 S.Ct. at 1198. (emphasis added), in *Willington* the nursing home debtor *never decided* to reject and by its day-to-day conduct indicated just the opposite.

However, as the Trustee has admitted:

> "*Bildisco* does not hold for the proposition that a debtor-in-possession may accept the benefits of a contract without incurring corresponding obligations. Pending formal assumption or rejection of the contract, the debtor is 'obligated to pay for the reasonable value' of services rendered to it by the other parties to the agreement. 104 S.Ct. at 1199." Brief 27.

This is significant because the provider agreement between Willington and the State defined "reasonable value" as the allowable costs actually expended and devoted to patient care as per the Connecticut Medicaid Cost Related Reimbursement System regulations. (i.e., *after* verification by the field audit).

Thus, even the *Bildisco* Court itself would insist that Willington receive not a penny more than the reasonable value of the contractual services rendered, i.e., the cost claims in Willington's annual cost reports *after* implementation of the field audit. Otherwise, the contract would be violated, the debtor or its other creditors unjustly enriched, and payment in excess of "reasonable value" would take place.

The other Connecticut bankruptcy judge has declared that the "definition of debt must . . . be read in the context of . . . [the legislative] policy" that "the bankruptcy laws are not a haven for criminal offenders, but are designed to give relief from financial over-extension." *In Re Pellegrino*, 42 B.R. 129, 134 (Bankr. D.Conn. 1984).

In *Willington*, the debtor's owners falsified cost claims in order to gain illegally money for themselves. The doctrine of recoupment is an equitable doctrine which allows the courts to protect innocent state Medicaid agencies victimized by false cost claims by health care providers in the same transaction pursuant to which the recoupment takes place, and such doctrine is most applicable to the fact pattern here as the district court correctly held.

Docket Nos. 87-5021, 87-5023

UNITED STATES COURT OF APPEALS
for the
SECOND CIRCUIT

At a stated Term of the United States Court of Appeals for the Second Circuit, held at the United States Courthouse in the City of New York, on the fifteenth day of June one thousand nine hundred and eighty-eight.

Present: Hon. James L. Oakes
Hon. Jon O. Newman
Hon. Roger J. Miner
Circuit Judges

IN RE: WILLINGTON CONVALESCENT HOME, INC.
Debtor

MARTIN W. HOFFMAN, TRUSTEE
Plaintiff-Appellant,

— against —

STATE OF CONNECTICUT,
DEPARTMENT OF INCOME MAINTENANCE
AND STATE OF CONNECTICUT,
DEPARTMENT OF HEALTH SERVICES,
Defendants-Appellees,

UNITED STATES OF AMERICA,
Intervenor-Appellee

IN RE: EDWARD ZERA,
Debtor

MARTIN W. HOFFMAN, TRUSTEE
Plaintiff-Appellant,

— against —

STATE OF CONNECTICUT,
DEPARTMENT OF REVENUE SERVICES
Defendant-Appellee,

UNITED STATES OF AMERICA,
Intervenor-Appellee

Appeal from the United States District Court for the District of Connecticut.

This cause came on to be heard on the transcript of record from the United States District Court for the District of Connecticut, and was argued by counsel.

ON CONSIDERATION WHEREOF, it is now hereby ordered, adjudged, and decreed that the judgment of said District Court be and it hereby is affirmed in accordance with the opinion of this court with costs to be taxed against the appellant.

ELAINE B. GOLDSMITH, Clerk
/s/ Edward J. Guardaro
By: Edward J. Guardaro
Deputy Clerk